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American Woman's Society of Certified Public Accountants

American Society of Women Accountants

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Editor's Notes

Why Different Meanings?

Like Alice, accountants insist that words mean what we want them to mean. But today's consumer of accounting information will not be as naive and agreeable as the white rabbit. In the search for accounting principles disagreement on the meaning of words and phrases arose from the beginning.

Accountants boast that accounting is the language of business. Is one of the marks of a profession a jargon that only its practitioners understand? (Maybe we should say that accounting is the jargon of business.)

As a field of activity expands, a need for new modes of expression arises. That need may be met by the development of new words or by expanding the meaning of words already in use. Either course has its dangers; in one case that of not being understood, in the other being misunderstood. In accounting the need for clarification of terminology came with the growth of an old activity. The second alternative was adopted and the threat of being misunderstood became a reality.

Committee on Terminology. One of the first semantical discussions by accountants centered on the meaning of principle. The Committee on Terminology divided on an appropriate definition for the term. Some committee members contended that a principle was "A fundamental truth or proposition on which others may depend." Other members contended that a principle was "A general law or rule adopted or professed as a guide to action." Those opting for the latter meaning prevailed. Thus accounting principles became rules or guides to action.

The definition of an asset offers another example of the search for acceptable terminology. Terminology Bulletin No. 1 defines an asset as "Something represented by a debit balance that is . . . properly carried forward upon a closing of the books of account . . ." In turn, a liability was "something represented by a credit balance that is . . . properly carried forward upon a closing

of books of account . . ." Paragraph 21 states ". . . a balance sheet may be defined as: A tabular statement or summary of balances (debit and credit) carried forward after . . . closing of books of account . . ." Confusing? Yes! Especially since economists were defining assets as items having economic value and liabilities as financial obligations. A dictionary of that time (1934) gave the definition of a balance sheet as a "statement made to show the true state of a particular business."

As the users of financial statements increased, many of the terms used came under fire. To the accountant the term *earned surplus* meant earnings kept in the business. To the public the term surplus meant an excess, thus "earned surplus" became an excess created by earnings. During the 1930's economists advocated that businesses reinvesting their surpluses would bring the country out of the depression. In most instances profits were already invested in inventories and fixed assets. If economists, trained in business affairs, misunderstood our terminology how much greater must have been the misunderstanding of the investor.

The use of the term *reserve* also caused misunderstanding. Many believed that the "Reserve for Depreciation" represented a cash reserve that could be used to replace fixed assets. *Net Worth* (used as the caption for the capital section) implied the value of a firm.

The above are just a sampling of the accountant's expansion of the meaning of words. Criticism forced the profession to change some of its terminology. In the process, *earned surplus* became *retained earnings*, *net worth* became *owner's equity*, and *reserves* became *allowances*.

What about Today? Do today's readers understand the statements? Not according to the article by Barnett that begins on page 3. Are financial statements easy to read? Not according to Holley in his article beginning on page 9. Barnett's study reports that less than 50 percent of the readers perceive "fairly present" in

the auditor's report to mean what the accountants perceive it to mean, i.e., that the statements are fairly presented in accordance with GAAP. If accountants cannot agree on a set of GAAP, how are consumers expected to read the statements with any degree of confidence. Shouldn't the term be deleted from the auditor's report?

Holley's article reports that financial statements have not improved in readability over the past 30 years, and that they are dull and difficult to read when measured by the Flesch technique. Must the accounting profession continue to use a language that its members cannot agree on? Must we emulate the medical profession whose members write prescriptions in Latin and the legal profession whose documents contain many Latin terms? The layman cannot interpret the prescription nor understand many legal documents. Maybe accounting reports should be in Latin. Then the consumer would make no effort to understand, thus there would be a minimum of misunderstanding. (Imagine how the SEC and FTC would handle that one!)

A Ray of Sunshine. There are some rays of sunshine penetrating the clouds. No, we do not have new terminology bulletins. But parts of the profession no longer resemble the *slinky* that gracefully returns to its original form regardless of the efforts to change its shape. Constant pressure is making it difficult to return to its original stance.

The FASB exposure draft "The Elements of Financial Statements" gives new definitions for several basic terms. Assets are defined as future economic benefits and liabilities as financial obligations of an enterprise, definitions that probably closely correspond to those of consumers. Other terms defined are: owners' equity, comprehensive income, revenues, expenses, gains, and losses.

Accountants are recognizing the need for giving more consideration to the needs of consumers. No longer can we continue to give consumers what we think that they ought to have!

Opinion. Unlike Alice, no longer can the terms mean what we want them to mean, unless we want them to mean what the consumer thinks that they mean.